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THE ALBERTA SECURITIES COMMISSION: DISCUSSION PAPER

Submitted by: The Honourable Elaine J. McCoy, M.L.A.
Minister of Consumer and Corporate Affairs

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THE ALBERTA SECURITIES COMMISSION: DISCUSSION PAPER

I. INTRODUCTION

A Committee was appointed by the Honourable Elaine McCoy, Minister of Consumer and Corporate Affairs, in late 1986 to advise her about the role, structure, function and organization of the Alberta Securities Commission.

Its terms of reference were as follows:

1. To analyse the current role and functions, and review the current organization and structure of the Commission;

2. To assess whether changes in the role, functions or organization of the Commission would enhance the regulation of securities in Alberta;

3. To recommend to the Minister what changes, if any, should be made;

4. To provide to the Minister an itemized, chronological plan for implementing the Committee's recommendations.

The Minister asked the Committee to report by March 31, 1987.

The Committee was composed of Professor D.P. Jones (Chairman); Mr. W. D. Grace, F.C.A.; and Mr. A. F. Collins. The

Committee was ably assisted by Counsel, Mr. Raymond K. Bodnarek, seconded from the Attorney General's Department, and by the Committee's secretary, Mrs. Shirley Hlushak.

In the course of its proceedings, the Committee met with the Chairman, members and various staff of the Securities Commission; members of the Securities Bar in both Calgary and Edmonton; representatives of the investment community, including the Investment Dealers' Association and the Alberta Stock Exchange; officials from the new British Columbia Securities Commission and the Ontario Securities Commission; members of the Attorney General's Department; and it corresponded with a number of other persons.

The Committee was created as a result of the Minister's concern that the current structure of the Securities Commission may create a perception of conflict between its role as an investigator and prosecutor of various offences under the Act on the one hand, and as a judge in these very same matters on the other hand. This Paper addresses the problem in Section III ("Description of the Current Functions of the Commission") and Section IV ("The Conflict of Roles and Possible Solutions").

This inevitably led the Committee to consider the purpose, role and reason for the existence of the Securities Commission.

Is it merely to ensure "full, true and plain disclosure" of all relevant information concerning a transaction in a security? Is it to protect "unsophisticated investors"? Is it to encourage the development of an investment and a financial industry in Alberta? Is it to maintain a fair market place over time? Section II of the Paper considers the purpose for having a Commission, and suggests that the Act be amended to include a "mission statement" for the Commission. Section III provides a brief description of the powers and duties granted to the Commission, its staff and the courts under the current Securities Act.

Having made an appraisal of the proper role of the Commission, the Committee then tried to determine whether the effective achievement of this goal could be increased by changing the structure, personnel or resources available to the Commission. Section V ("Making the Commission More Effective") addresses this question.

Section VI makes a number of recommendations concerning the relationship between the Commission and the Alberta Stock Exchange.

Section VII considers whether the Commission's present role should be continued with respect to franchises.

Section VIII attempts to deal with the demands which will be placed upon the Commission as a result of the rapid deregulation of the securities industry in Canada, with particular reference to the abolition of the structural separation of the "four pillars" and the general "globalization" of the securities industry. The speed of developments resulting from deregulation makes it extremely difficult to predict accurately what changes will need to be made to ensure effective securities regulation in Alberta. This will require continual monitoring by the Government for the foreseeable future, as well as the creation of a regulatory structure which is flexible enough to cope with such rapid and fundamental changes.

The Committee reported that it received a very clear message from virtually all of the participants in the securities industry to the effect that:

(i) There <u>is</u> a continuing need for a Securities Commission.

(ii) The Commission has a broader role than merely ensuring "full, true and plain disclosure" concerning investments.

(iii) The Alberta Securities Commission gets high marks from the people with whom it deals on

> a daily basis, who note a particular improvement in its service over the last year and a half or so; and who are quite clear that it is receptive and responsive.

In other words, while certain technical matters may need to be corrected, there is no need (and it would be dangerous) to attempt wholesale structural changes to the present system, which follows the recognized North American model for regulating the securities industry. The Committee was struck by the strength and virtual unanimity of the sentiments, and thought it appropriate that they be recorded here.

II. THE PURPOSE OF THE SECURITIES COMMISSION

Several distinct views exist as to the proper role of the Securities Commission.

A few people insisted that the only proper role of the Commission is to ensure that "full, true and plain disclosure" is made available in a public registry so as to permit purchasers of securities to have access to knowledge in order to appraise their risks and make their decisions accordingly. This view strongly emphasizes the principle of *caveat emptor*. It also assumes that "full, true and plain disclosure" is all that is required to ensure that the capital markets work fairly. This approach relies exclusively on the heavy hand of the criminal law for *ex post facto* punishment of breaches of "full, true and plain disclosure", and assumes that current remedies in the civil courts are (or could easily be made) adequate, inexpensive and rapid enough to compensate investors who are victims of unscrupulous activities in the securities industry. It virtually eliminates any *ex ante* administrative vetting of either the players or the transactions in the capital markets.

It is generally assumed that the requirement of "full, true and plain disclosure" in the regulation of the securities market

is designed to protect the small and unsophisticated investor by giving access to information. This explains the rationale behind the existence of the very broad exemptions in the Act[1], which generally speaking exempt either large transactions (over $97,000[2]) or sales to large purchasers from being subject to the detailed regulatory requirements of the Act.

However, there also exists a broader view of the proper purpose of regulating the securities industry -- namely, to ensure that the securities market operates fairly over time. This concept recognizes that "full, true and plain disclosure" by itself may not be enough to ensure the fair operation of the securities market. This broader view is reflected in the provisions in the current legislation which permit the Commission to refuse to issue a receipt for a prospectus (which power is not restricted to the sole ground that the prospectus does not contain "full, true and plain disclosure"), its power to refuse or revoke the registration of a trader (again, not restricted to the absence of "full, true and plain disclosure"), the inclusion of Part 13 in the Act dealing with take-over bids and Part 12 dealing with Proxies and Proxy Solicitation, the prohibitions in

1 Securities Act, S.A. 1981, c. S.-6.1, as amended by S.A. 1984, c. 64 (proclaimed 15 March 1987).

2 Derived from a transaction of $100,000 less a notional commission of $3,000.

Part 14 against improper profiting from insider trading, and the prohibition in Section 52 against operating a stock exchange in Alberta without the permission of the Commission. Indeed, this broader role for the Securities Commission has been demonstrated very recently by the Canadian Tire case, where the Ontario, Quebec (and Alberta) Commissions prohibited the takeover by the dealers of a controlling interest in the Corporation without making an equivalent offer to the non-voting shareholders--notwithstanding the fact that "full, true and plain disclosure" was made throughout, and notwithstanding that the transaction complied with every legal technicality. The ruling by the Commission was upheld on a challenge before the Ontario Divisional Court in March 1987.[3]

The Committee thought it important for the Securities Commission to have this broader role of maintaining fairness in the marketplace. They also thought it impossible for any legislation to identify in advance all of the possible types of unfair transactions or behaviour which could be devised in the future, so that it is necessary to give the Securities Commission broad discretionary power to be able to prevent these types of

3 Application has been made for leave to appeal to the Ontario Court of Appeal.

transactions from being consummated.[4]

It had also been suggested to the Committee that the legislation should specifically require the Commission to consider the desirability of developing a viable capital market within Alberta as being part of the "public interest" which the Commission must consider in exercising many of its discretionary powers under the Act. The Committee rejected the suggestion that the role of the Securities Commission is to create the capital market instead of regulating what the private market creates. However, they did believe that the Commission should whenever possible play a positive role in creating a regulatory climate that is conducive to a viable capital market in Alberta.

The Committee also thought it important to emphasize that the Commission does not provide a guarantee that investors will not lose money through bad investments, and that this is not a role which can or should be assigned to the Commission. Nevertheless, members of the public who have lost money or

4 This discretionary power to prevent the completion of unfair transactions is totally different from a discretionary power to punish persons for activity which was not illegal when it occurred. There is no need to grant the Commission the power to define offences (punishable in the courts) retroactively; but it does need power to prevent the completion of transactions which are otherwise technically legal, or to prevent undesirable persons from participating in the securities industry.

securities -- whether or not there has been unscrupulous activity towards them -- will tend to blame the Commission; and it is important to recognize that this criticism is not necessarily properly directed at the Commission.

Because the legislation in fact now assigns various different functions to the Commission, and because the public has different perceptions about the proper role of the regulation of the securities industry, the Committee thought it would be desirable for the current legislation to be amended to provide a "mission statement" for the Commission. The Committee also suggested the following amendments to the Act:

s.1(r.2) "public interest" includes

(i) full, true and plain disclosure with respect to all securities

(ii) the maintenance of a fair securities market

(iii) achieving a regulatory climate that is conducive to a viable capital market in Alberta

(iv) any other matter which the Commission thinks is relevant.

s.10(1) The Alberta Securities Commission is continued and is responsible for

(a) the administration of this Act and the regulations

(b) maintaining a fair market place in securities in Alberta, and

(c) achieving a regulatory climate that is conducive to a viable capital market in Alberta.

III. DESCRIPTION OF THE CURRENT FUNCTIONS OF THE COMMISSION

The Alberta Securities Commission is composed of a Chairman and not more than six other members appointed by the Lieutenant Governor in Council. The Chairman is designated as the "Chief Executive Officer of the Commission", and is required to devote his full time to the work of the Commission; all other members are part-time (section 11). Although section 11(1) contemplates that a member might be designated as Vice-Chairman, to date no such designation has occurred.

The Commission has either initial or final authority with respect to virtually every matter under the Securities Act. Thus, although the Act itself grants broad powers to the Director[5] (who in section 13 is stated to be the "Chief Administrative Officer of the Commission", subject to the direction of the Commission), section 24 specifically permits a person or company directly affected by a decision of the Director to appeal that decision to the Commission.

Section 26 of the Act grants a very broad right of appeal from any decision of the Commission (except a ruling under section 116, which authorizes the Commission to exempt a trade

5 And section 14(3) authorizes the Commission to delegate most (but not quite all) of its powers to the Director.

from the requirements of sections 54 or 81 or to determine when a distribution has been concluded or is still in progress). Thus, the Court of Appeal may

(a) confirm, vary or reject the decision of the Commission,

(b) direct the Commission to re-hear the matter, or

(c) make any decision that the Commission could have made and substitute its decision for that of the Commission.

In other words, the Court of Appeal's jurisdiction is not limited -- and specifically is not limited to questions of "law or jurisdiction" -- but rather includes the full discretion of the Commission itself.

Part 2 of the Act principally provides for specific investigations which are to be undertaken only on the direction of the Commission itself or the Minister of Consumer and Corporate Affairs. In addition, it grants to the Commission (or its delegate) the power in certain other circumstances to freeze property; the power to apply to the Court of Queen's Bench for the appointment of a receiver, manager, trustee or liquidator; and matters incidental thereto.

Part 3 authorizes the Commission to audit the financial affairs of various participants in the securities industry; and requires the Alberta District of the Investment Dealers' Association of Canada and the Alberta Stock Exchange to appoint

auditors and make regulations with respect to audits of their members.

Part 4 prohibits the operation of a stock exchange in Alberta unless recognized by the Commission; and gives the Commission broad regulatory power over a recognized stock exchange.

Part 5 contains a general prohibition against the participation of unregistered persons in the securities industry in Alberta. It details a broad scheme for the registration of such participants -- which is run by the Director (with a right of appeal to the Commission under section 24). And it authorizes the Commission to suspend, cancel or restrict the registration of a registrant in very broad discretionary circumstances.

Part 6 provides statutory exemptions from the registration requirement imposed by section 5 on participants in the industry. Some of these exemptions are discretionary (for example, section 64 provides that registration could nevertheless be ordered by the Commission, notwithstanding the statutory indication that it is not required); other exemptions are non-discretionary (for example, sections 65, 66, 67).

Part 7 sets out a number of detailed rules regulating the

trading of securities generally.

Part 8 imposes a general obligation on all persons involved in the distribution of previously unissued securities to file and receive a receipt for a prospectus from the Commission. The purpose of this system is to ensure "full, true and plain disclosure" of all material facts relating to the securities offered by the prospectus.

Part 9 regulates the sales activities of persons involved in the distribution of securities during the period of time between the filing of a preliminary prospectus and the issuance of a receipt for a final prospectus.

Part 10 provides a wide range of exemptions from the requirements for filing a prospectus. Most of these are peremptory exemptions so that the prior approval of the Commission is not required for their availability. (However, section 108(1) requires a report to be filed with the Commission with respect to many of these exempt trades.) In addition, section 116 permits the Commission (or its delegate) to exercise its discretion to exempt any other distribution from the prospectus requirement (and its decision on this is final and not capable of an appeal to the Court of Appeal).

Part 11 requires reporting issuers to make continuous disclosure of material changes in their affairs, and to make continuous disclosure of certain other financial information. Sections 123 and 125 permit the Commission to exempt particular issuers from these reporting requirements.

Part 12 regulates the content and solicitation of proxies.

Part 13 generally sets out the rules for takeover bids and issuer bids. Section 132 and 133 provide certain exceptions to these general rules; and section 145 authorizes the Commission to exercise its discretion to exempt any person or company from these requirements "if in the opinion of the Commission it would not be prejudicial to the public interest to do so".[6]

Part 14 deals with insider trading and self-dealing. On the one hand, it requires all insiders to file a report of any of their dealings in the securities of the reporting issuer in question. On the other hand, it also prohibits self-dealing between a mutual fund and various officers and directors thereof, and prohibits certain types of inside trades in a mutual fund or by a portfolio manager. (Note that section 171(9) imposes a civil

6 Many sections in the Act refer to the "public interest" which currently is not defined at all. See, e.g., ss. 56, 96, 116, 117, 125, 145, 184 and 186.

obligation to pay damages or compensation on an insider who has improperly benefited from his inside knowledge.)

Part 15 is entitled "Enforcement". Section 161 creates a number of offences and imposes financial and imprisonment penalties for breaches thereof. Section 162 requires the Attorney General's consent for the institution of proceedings under section 161. Section 164 authorizes the Commission to apply to the Court of Queen's Bench for an order directing a person to comply with the requirements of the Act.

Section 165 authorizes the Commission to cease trade a particular security, or to prohibit a particular person from trading in securities (although sub-section (2) requires that a hearing be conducted prior to such an order, section 21 permits an interim order lasting 15 days without a hearing, which may be extended until the hearing).

Section 166 permits the Commission to cancel any or all of the statutory exemptions contained in the Act -- whether from the requirements for registration as a trader or registration of a prospectus. Again, sub-section 166(2) provides that such a revocation shall not occur without a hearing, although section 21 permits an interim revocation for 15 days (which may be extended).

Section 167 prescribes the following limitations:

(a) for proceedings in a court, one year from the day that the facts upon which the proceedings are based first came to the knowledge of the Commission;

(b) for proceedings before the Commission, two years from the day that the facts upon which the proceedings are based first came to the knowledge of the Commission.

Part 16 imposes civil liability in the courts (not before the Commission) for various actions committed by traders with respect to prospectuses, circulars, statements of material fact or change. The form of this liability is a damage action, or an action for compensation (section 171), as well as a right of rescission.

Section 172 authorizes the Commission or various other persons to apply to the Court of Queen's Bench for orders compelling a reporting issuer or a mutual fund to enforce its rights to be recompensed for breaches under section 171 of the Act.

Part 17 authorizes the Commission to recognize various "self-regulating bodies", and to hear appeals therefrom. The purpose of this is to permit or authorize the self-regulating bodies to administer various parts of the Act and the regulations as they relate to the members of the self-regulating body.

Part 18 is entitled "General Provisions". Among other things, section 184 authorizes the Commission to co-ordinate its activities with those of securities regulators in other jurisdictions; section 185 authorizes the Commission by order to "exempt any person, company, trade or distribution from all or any provision of this Act or the regulations"; and section 193 grants the Commission and any member of it, or its staff, immunity from damage actions for any act done in good faith (although it maintains the liability of the Crown in these circumstances). In addition, section 196 authorizes the Lieutenant Governor in Council to make a wide range of regulations for the operation of the Act.

IV. THE CONFLICT OF ROLES AND POSSIBLE SOLUTIONS

Inherent in the current structure of the Securities Commission is the perceived institutional bias resulting from its conflict of roles. The Securities Commission has created informal barriers within the Commission structure which are designed to eliminate any actual conflict.[7] Thus, the Chairman endeavours not to sit on any panel of the Commission hearing a matter in which he was previously involved in the investigation or the decision to refer matters to the Attorney-General for prosecution or the decision to commence proceedings before the Commission. Nonetheless, these informal barriers do not alleviate the perception of conflict. Therefore, the real problem with the current Commission structure is mostly one of perception rather than fact. Consequently, any proposed solution must deal squarely with the perception problem.

The two leading cases regarding the conflict of roles are Barry and Brosseau and Alberta Securities Commission (the "Barry case"), February 6, 1986 (unreported) and Malartic Hygrade Goldmines (Canada) Ltd and Ontario Securities Commission, April

7 Such as gave rise to the successful court challenge in R. v. Alberta Securities Commission, ex parte Albrecht, (1963) 36 D.L.R. (2d) 199 (Alta. S.C.).

1, 1986 (unreported).[8] In both cases the Alberta Securities Commission and the Ontario Securities Commission respectively were challenged for exercising the roles of investigator and prosecutor on the one hand, and the role of judge on the other hand with respect to the same matter.[9]

It is important to note that the perceived conflict arising from the Securities Commission's concurrent exercise of the aforementioned roles does not arise in every situation (e.g. causing matters to be referred to the courts, or formulating policy).

In order to create a Commission structure which avoids the perception of conflict, it is essential to determine the circumstances under which the perceived conflict arises. Accordingly, it is necessary to examine the various functions of the Commission in regulating securities in Alberta.

Securities regulation in Alberta can be categorized into the following three forms:

8 In addition, see McBain v. Canadian Human Rights Commission, (1985) 22 D.L.R. (4th) 119 (F.C.A.).

9 In both cases, the courts upheld the validity of the Commission structure, and held that there was in law no perception of bias. However, the Supreme Court of Canada has given leave to appeal to one of the participants in the Barry case.

Category 1. Offences which go to the Courts

Category 1 includes criminal code offences such as fraud and theft. The Securities Commission (or its staff) may be involved with the initial investigation of these matters. However, these investigations are eventually turned over to the Commercial Crime Unit of the RCMP; the prosecution is done by the Attorney-General's office; and these matters are judged in the normal Court system.

Given the Securities Commission's lack of involvement in the prosecution and judging roles, there is no potential for a perceived conflict to arise out of its investigatory activity.

Another category of court-determined offences arises under section 161 of the Act. This involves offences punishable by summary conviction in the Provincial Court. The Securities Commission is fully involved in the investigation of these matters; and, in addition, is involved in the prosecution of a large percentage of these offences. However, because the judging is done by the ordinary court system, there is no potential for a perception of conflict.

Category 2. "Disciplinary" Proceedings before the Commission

Category 2 involves the exercise by the Commission of its discretionary powers on an ex post facto basis to discipline or impose sanctions on persons or transactions which the Commission finds to be unacceptable. Examples of this form of regulation are the Commission's imposition of cease trade orders or the removal of statutory exemptions with respect to a person or company who contravenes a provision of the Act or regulations.

In this category the Commission has the potential to exercise concurrently the role of investigator, prosecutor and judge with respect to the same matter. Therefore, in the context of this form of regulation, the perception of conflict clearly arises.

The perceived conflict is created by the fact that the Chairman of the Commission is not just the Chairman of the Commissioners, but is also the Chief Executive Officer of the Commission as a whole (the "Agency"). Therefore, it is possible on the one hand that the Chairman might in fact be involved at one or more steps from the instigation of investigation (a function of the Agency), to the decision to take proceedings before the Commission (i.e., the Commissioners), as well as

participating during the Commission's deliberations on whether to exercise its disciplinary powers in the particular case. Apart from actual participation by the Chairman or other Commissioners in the investigative and prosecution steps, a perception of bias may well arise due to the fact that the Commission (the "judge") hires its staff (the "police" and "prosecutor"), and the Chairman is Chief Executive Officer of the whole Agency.

In practice, Chairmen have been acutely aware of the potential for conflict and attempt to "insulate" themselves from matters which will likely result in a hearing before the Commissioners. In the event that the Chairman does become involved with a matter at the investigation or prosecution stage, he will disqualify himself from hearing the matter with the tribunal. This creation of internal barriers within the Commission designed to avoid actual conflicts is common among most Securities Commissions in Canada. Unfortunately, this method of dealing with conflict does not remedy the perception of conflict.

Category 3. Registration of Those Trading in Securities (e.g. Brokers, Dealers, and Sales People -- Collectively Referred to as "Players"); Registration of Securities; and the Discretionary Exemptions from either of these Registration Requirements

A very large part of the Commission's powers involve discretion whether to permit a particular transaction to occur, or whether to permit a particular person to participate in the securities industry. This discretion is exercised ex ante in that the Act generally prohibits sales of securities without the prior discretionary approval of the Commission. In law, this discretion belongs to the Commission itself, and must be exercised by the Commission with an open mind in each case that comes before it. However, it would be exceedingly cumbersome to require the Commission to exercise its discretion in each case, and the practice has developed whereby the Commission states in advance its policy as to how it will likely exercise its discretion in a wide range of cases. The staff of the Commission then apply this policy to the various applications which come forward. Obviously, if a particular applicant complies with the policy, then the staff will (generally)[10] grant whatever permission is required, and the particular matter never gets

10 The Canadian Tire case demonstrates an exceptional case where the staff refused to permit a transaction which apparently did not contravene any policy enunciated by the Commission. This staff action caused the matter to be remitted up to the Commission itself for determination and the Commission exercised its discretion to prohibit the transaction.

before the Commission itself.

A particular matter may be brought before the Commission itself in two different circumstances. First, there may be a disagreement between the Agency staff and the applicant as to whether the particular matter does or does not comply with the policy. Secondly, there may be no such disagreement, but the applicant may assert that the policy is wrong or ought not to apply to it in its particular circumstances. In both cases, the Commission itself will be called upon to exercise -- for the first time, in law -- the discretion which the Act has imposed upon it. This is not really an "appeal" at all in the proper sense of the word. Accordingly, there can be no actual or perceived conflict between the Commission's exercise of its discretion and the involvement of its staff (who do not really exercise any independent legal discretion of their own).

With respect to registration, this category of regulation in practice involves the Director's determination of whether a player or a security has complied with the Act, regulations, or policy statements. If so, the Director may grant registration or direct the issuance of a receipt for a prospectus respectively. On the other hand, if the Director determines that the matter involves a substantial policy issue he may refer the matter to the Commission for determination. The Commission does not become

involved in a registration matter unless there is either a referral by or an appeal from the Director.

With respect to discretionary exemptions, hearings are held before the Commission.

In light of the above analysis, it can be seen that the perception of conflict only arises in the context of what is described as Category 2 (Disciplinary Proceedings). In particular, the problem arises from the fact that the Chairman is the Chief Executive Officer of the Commissioners and the Agency as a whole and therefore the potential exists for his involvement in the investigation and prosecution on the one hand and the judging on the other hand, of the same matter.

The Committee has devised a number of alternative structural models of the Securities Commission which attempt to remove the built-in conflict of the current two-tiered structure:

1. Model 1 shows the current structure of the Commission and staff.

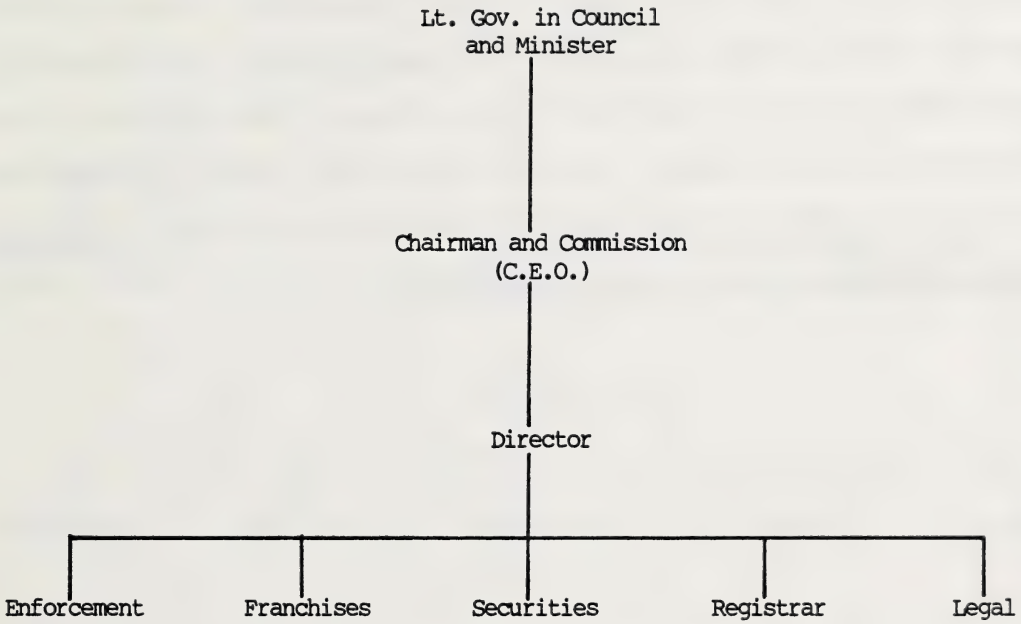
2. Model 2 creates a new "Tribunal" to act as judge, and which is separate from the Commission, which otherwise exercises its current functions.

3. Model 3 cuts the umbilical cord between the Commission and its staff by removing the Chairman's designation of "Chief Executive Officer" of the entire Agency.

4. Model 4 is a variant on Model 3, and also closely resembles the current structure (Model 1). It does not formally sever the connection between the Commission and its staff. It retains the Chairman's designation as "Chief Executive Officer", but it formalizes the current practice that the Chairman will not sit on any matter at the Commission level in which he has been previously involved in an executive capacity.

5. Model 5 removes the investigative function from the Commission by allocating it to some other governmental agency, thereby attempting to avoid the perception of bias.

Model 1 - THE CURRENT STRUCTURE



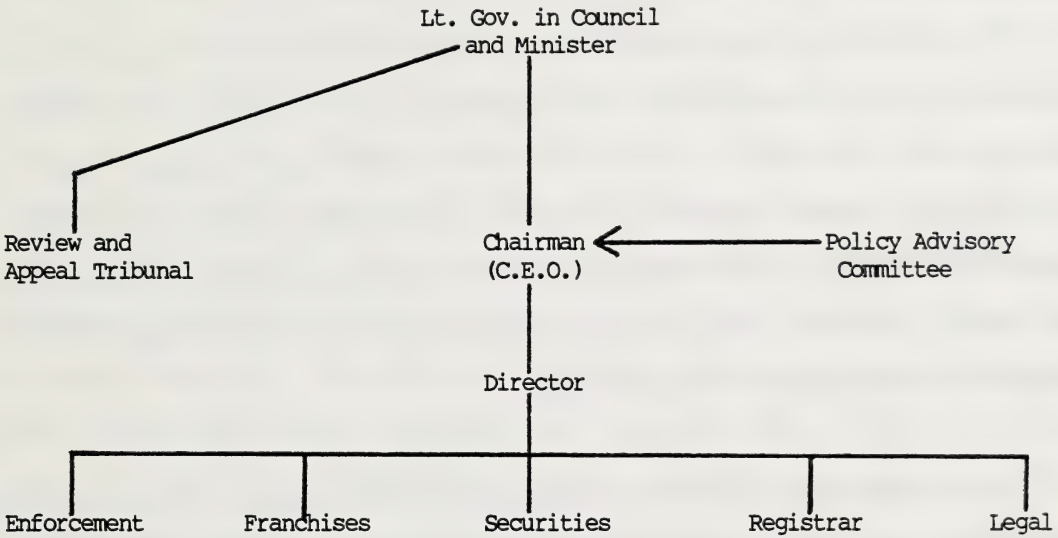
The diagram above sets out the current structure of the Alberta Securities Commission. It reflects the statutory designation of the Chairman as Chief Executive Officer. In this capacity, the Chairman may be involved in any aspect of the day-to-day administration of the Act -- including whether particular investigations are to be undertaken, or whether particular matters are to be referred to the Attorney-General's office for

prosecution under the Criminal Code or for offences under section 161 of the Act, whether to institute disciplinary (i.e., Category 2) proceedings before the Commission itself, or may make a decision as a one-member panel of the Commission (which can be appealed to the whole Commission[11]). Any *actual* involvement in these administrative matters will prevent the Chairman from participating as a member of the Commission itself if and when the (or possibly a related) matter comes before it: *R.* v. *Alberta Securities Commission, ex parte Albrecht.*[12]

11 Section 23.

12 See note 7, *supra*.

Model 2 - A SEPARATE JUDGE



Model 2 indicates the creation of a Review and Appeal Tribunal (the "Tribunal") as a separate entity to act as judge. This separation of function eliminates the perception of bias because the Chairman, Director and staff of the Commission would not be part of the Tribunal.

Model 2 does not contemplate transferring to the Tribunal any of the functions which currently are assigned to the Courts. This model does, however, contemplate that the Tribunal would

exercise all of the functions of the present Commission in Category 2 (ex post facto disciplinary matters) and Category 3 (ex ante exercises of discretion).

This Model effectively abolishes the current part-time members of the Commission, and leaves the Chairman (or "Chief Executive Officer"). It is not clear why, under such a structure, there should be both a Chairman and a Director, instead of having the Deputy Directors of Enforcement, Franchises and Securities as well as the Registrar and the legal staff reporting directly to the Chairman.

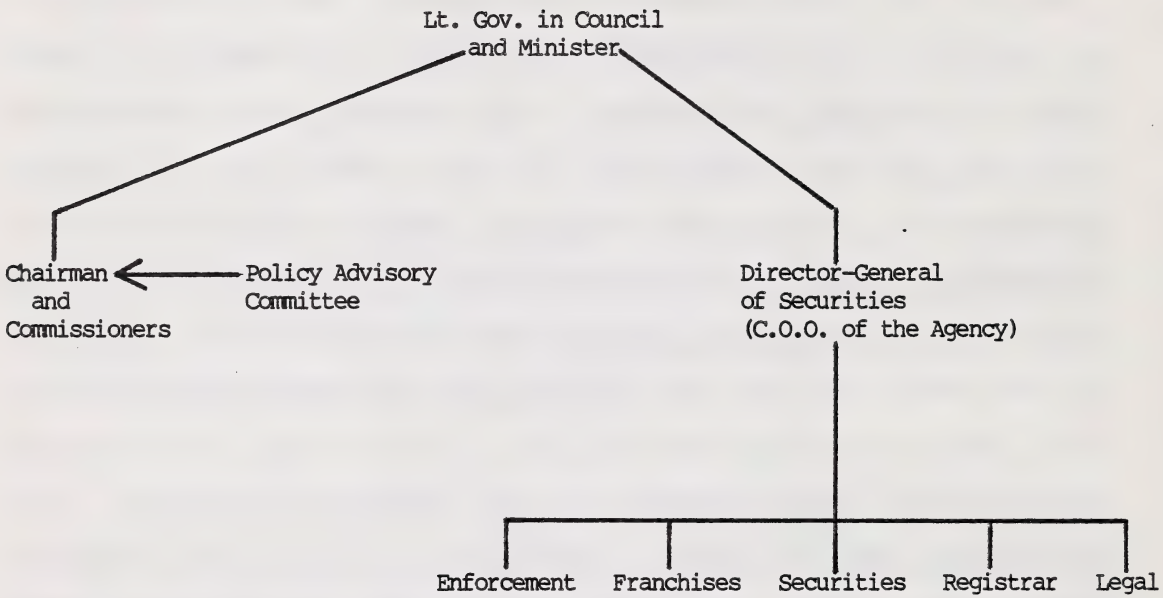
The Tribunal would be composed of a number of part-time members. A permanent part-time Chairman of the Tribunal would be responsible for administrative matters relating to the Tribunal, including the creation of the particular panels to hear particular matters. The Chairman of the Tribunal would not necessarily chair each panel; other members could be designated for this purpose from time to time. It would be desirable to provide for a mechanism for the appointment of additional members of the Tribunal as required, either for their specialized expertise or to provide extra manpower to deal with increased volumes of work or when conflicts of interest prevent the creation of a panel from the existing part-time members of the Tribunal.

Model 2 also shows a Policy Advisory Committee (which the Ministerial Advisory Committee recommended should be created regardless of which model is chosen) to be created to broaden the input of the various parts of the industry into the formulation of policy by the Commission. In Model 2, the Policy Advisory Committee advises the Chairman of the Agency, who is responsible for the initial formulation of policy (that is, an advance indication as to how the Agency will exercise its discretion in particular cases). As discussed in Section V below, the Policy Advisory Committee would be appointed by the Minister to provide a broad basis for the consideration and implementation of policy. The Committee might consist of a core group representing identifiable constituencies in the securities industry. This arrangement should provide a better structure for the systematic gathering of input on policy matters from the industry before policy is made. Provision might also be made for either

(i) the addition of extra members to consider particular issues where their particular expertise would be useful; or

(ii) the creation of an ad hoc panel for consideration of particular matters.

Model 3 - SEPARATING THE ADMINISTRATION FROM THE COMMISSION



Model 3 illustrates another way of removing the perceived bias -- by deleting the designation of the Chairman as the "Chief Executive Officer" of the whole Agency, restricting his role to the Chairmanship of the Commission itself (or "Board"), and having the Director-General of Securities as the Chief Operating Officer of the Agency appointed directly by the Lieutenant Governor in Council.

Under this strucutre, the Chairman and the Commissioners perform exactly the same functions as under the current structure in the Act, such as the exercise of the Commission's discretion over a wide range of subjects including exemptions, enforcement (for example cease trade orders and the removal of statutory exemptions) and "appeals" from the operating decisions of the Director and his subordinates. The important difference is that, under Model 3, the Chairman is not the Chief Executive Officer of the whole Agency, but rather only presides over the Commissioners.

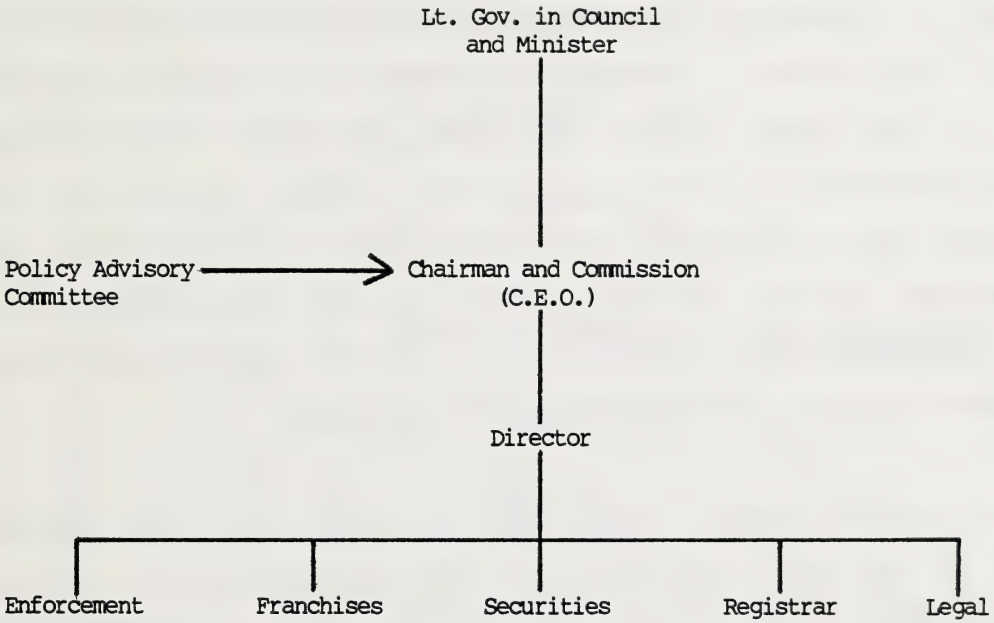
The Model contemplates that the administration of the Act will be done by the Chief Operating Officer of the Agency (the "Director-General"), who would be appointed by the Lieutenant Governor in Council, and who would not report to the Chairman or the Commissioners. The Director-General of Securities would be responsible for the following functions:

> investigations, including the referral of various possible offences to the Attorney-General's office for prosecution;
>
> the application of statutory requirements contained in the Act;
>
> the implementation at an operating level of policy set by the Commission; and
>
> the right to refer various matters to the Commission for determination, including the right to appear before the Commission on all matters.

In order to eliminate any perception of bias, it is essential that the Director-General not report to the Chairman or the Commissioners, but rather report to the Minister. This structure resembles the legal system in that the police and prosecution do not report to the judges; nor are the judges responsible for the police or prosecution on a day-to-day administrative basis.

Model 3 also shows the Policy Advisory Committee. Its composition would be identical to that described in the previous Model. However, Model 3 contemplates that the Policy Advisory Committee would advise the Commissioners in its formulation of policy indicating how it will exercise its discretion under the Act.

Model 4 - REINFORCING THE CHAIRMAN'S INFORMAL OPERATING DECISION NOT TO PARTICIPATE IN TWO ROLES

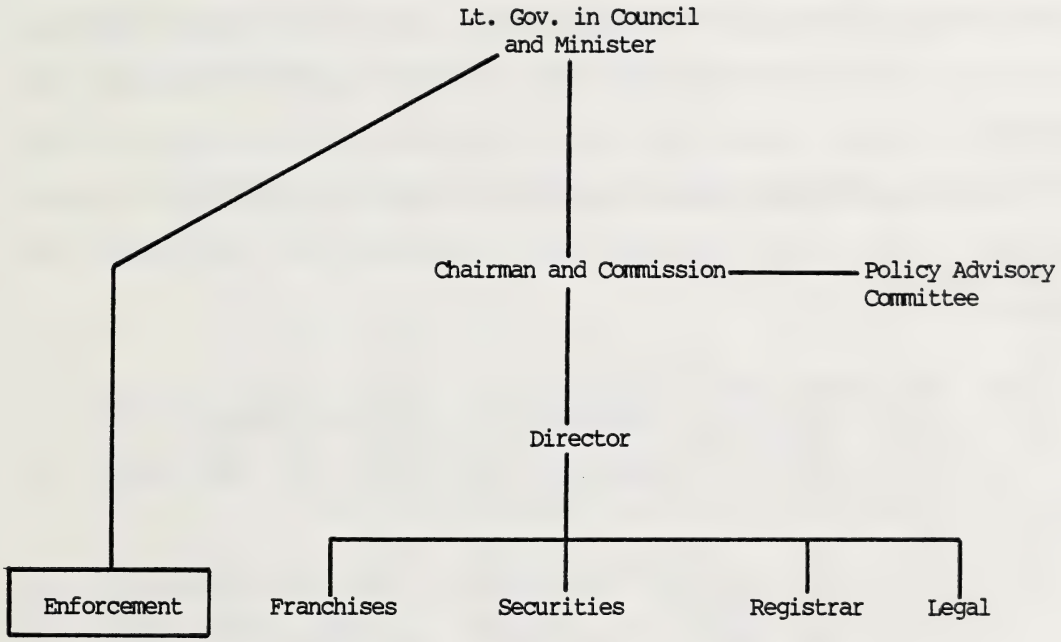


Model 4 maintains the current informal operating procedures for the Chairman not to participate in a particular matter in both his administrative role as Chief Executive Officer on the one hand and his role as Chairman and member of the Commission on the other hand; in addition, Model 4 adds a Policy Advisory Committee.

Unlike Model 3, this solution does not contemplate the abolition of the Chairman's role as Chief Executive Officer of the entire Agency, nor does it contemplate a structural division between the Commission (as "Board") exercising its discretionary powers (in Category 2 and Category 3 described above) and the role of the staff. Under this Model, therefore, the Chairman would endeavour to avoid actual bias such as occurred in the Albrecht case. However, this Model would not eliminate the perception of bias arising because of the Chairman's role as Chief Executive Officer and the fact that the Commissioners have responsibility for and authority over its staff.

In effect, Model 4 makes the judgement that the current model is the most appropriate (with the addition of a Policy Advisory Committee). It rejects the concept of "institutional bias", and suggests that no structural changes should be made to the Commission unless and until the Supreme Court of Canada rules that the present structure does create a legal problem.

Model 5 - REMOVING THE ENFORCEMENT FUNCTION FROM THE COMMISSION



A final way for eliminating the perception of bias would be to remove the enforcement function from the control of the current Commission -- either by making the Enforcement section report directly to the Minister or by making it part of the Attorney General's Department or some police unit. This arrangement would prevent the involvement of the Chairman and the Commissioners in any investigation of or decision to prosecute an alleged offender. This Model would be more attractive if it were

possible to group together the auditing, investigative and prosecutorial functions under similar financial legislation. Thus, in British Columbia many of these functions have been formally taken away from the Commission and co-ordinated within the Ministry of Finance and Corporate Relations with similar functions previously performed by the Superintendents of Insurance, Credit Unions and Trust Companies. Notwithstanding the attraction of such functional co-ordination, it is unlikely that this Model could be achieved in Alberta in the short run because:

(1) the three Superintendents no longer report to the same Minister in Alberta (the Superintendents of Trust Companies and Credit Unions now report to the Provincial Treasurer instead of the Minister of Consumer and Corporate Affairs); and

(2) there is a certain minimum critical level of activity required to perform the enforcement function effectively in each of these areas, and it is not obvious that great economies of scale would be achieved merely by centralizing this function in one location.

Further the enforcement function is greatly assisted by its interaction with the other administrators at the Securities Commission; and it seems unwise to insist on a structural divorce at this level.

In any event, part of the perception of bias arises from the participation of Commission staff in disciplinary proceedings

(Category 2) before the Commission. It is not clear that the only staff involved in the decision to bring such disciplinary matters before the Commission come from the Enforcement section. Accordingly, to the extent that other staff are involved, the perception of bias will not be eliminated merely by the removal of the enforcement function from the Commission.

For these reasons, the Committee discarded Model 5.

RECOMMENDATION

The Committee recommended the adoption of Model 3 as the best way to avoid the perception of institutional bias by eliminating the designation of the Chairman as "Chief Executive Officer" of the entire Agency, and thereby separating the judicial, disciplinary, and discretionary functions exercised by the Commissioners from the enforcement, prosecutorial, adversarial and administrative functions exercised under the Director General of Securities.

The implementation of Model 3 would require statutory amendments at several levels. At the primary level, the Securities Act must be amended so as to remove the current designation of Chairman as Chief Executive Officer of the Agency. In addition, the Director-General's position would have to be defined under the Act and made Chief Operating Officer of the Agency. The adoption of these primary amendments would necessitate the implementation of various consequential amendments to both the Securities Act and the regulations promulgated thereunder.

In general terms the consequential amendments can be slotted into the following two categories:

(1) Provisions dealing with duties and responsibilities currently performed by the Director.

The fact that the Director-General of Securities would become the Chief Operating Officer of the Agency means that all functions and responsibilities of the current Director would be subsumed under the Director-General's position. Therefore, all provisions relating to the current Director could be amended by simply replacing the term "Director" with the term "Director-General of Securities".

(2) Provisions relating to duties or responsibilities currently performed by the Commissioners which, upon implementation of the proposed amendments, would be dealt with by the Director General of Securities.

Changes to this category would be <u>substantive</u> in nature. That is, the Director-General's designation as Chief Operating Officer of the Agency would mean that certain matters currently under jurisdiction of the Commission (or "Board") would be transferred to the Director-General of Securities.

In addition to the above two categories, the Securities Act contains provisions relating to duties and responsibilities of the Agency as a whole. Under the current structure, the Chairman has the ultimate statutory control over these provisions given his designation as Chief Executive Officer of the Agency. However, the implementation of the proposed primary amendments

would shift the locus of control over the Agency to the Director-General of Securities. Nonetheless, these provisions would not require amendment because this shift of control to the Director-General of Securities would be made evident in the primary amendments.

V. MAKING THE COMMISSION MORE EFFECTIVE

In the course of the Committee's inquiry, a number of specific suggestions were raised about ways to make the Commission more effective. The following attempts to present those suggestions in an organized format.

(a) The Formulation of Policy

As indicated in the earlier discussion of the various models, the Committee recommended the creation of a Policy Advisory Committee to assist the Commission in the formulation of its policies. As indicated earlier, there is no specific legal status for the Commission's statements of policy; rather, they are written indications of how the Commission is likely to exercise (or not exercise) its vast discretionary powers in particular cases. In law, the Commission is bound to exercise its discretion with an open mind in every case which comes before it; but the law does not prevent the Commission from having a policy, and it is desirable for this policy to be articulated in advance so that persons affected by it can have the opportunity of dealing squarely with these concerns when making their applications to the Commission.

The Commission already tries to obtain public input into the formulation of its policy. However, it would be desirable to (1) broaden the groups who are regularly consulted; and (2) create a structure where particular members of each group are designated to be responsible for dealing with policy issues on behalf of their respective constituencies. The joint committee of the Canadian Bar Association and the Canadian Institute of Chartered Accountants on Taxation is a good model of a structured advisory committee. Also, the Canadian Institute of Chartered Accountants has developed an extensive Protocol for the development and circulation of "exposure drafts" of the policies which it proposes to implement for the purposes of defining generally accepted accounting principles.

The membership of the Advisory Committee could be designed to reflect various constituencies in the securities industry. In addition, the Minister could appoint one or more members of the Advisory Committee, to act as a conduit to convey the Government's view of desirable policies to the industry and to the Commission.

No legislative change would be required to implement an Advisory Committee (although section 27 of the current Act creates a "Financial Disclosure Advisory Board", which has never become operational, and which does not perform precisely the same

functions, although it could be adapted). The Committee commented that it should be possible to attract thoughtful and hard-working members of the Advisory Committee on a volunteer basis from the industry.

(b) The Vetting Function

Much of the criticism of the Commission stems from its vetting of prospectuses and similar documents for compliance with the requirement of "full, true and plain disclosure".

There is a distinct division in the types of issues and issuers who deal with the Commission: large issuers with national and international issues dealing with regulators in many jurisdictions; and more local issuers for whom the Alberta Securities Commission is one of the primary regulators. The appropriate level of vetting may differ between these two groups.

With respect to the large national and international issuers, there is considerable need to achieve general uniformity of approach to be adopted by the regulators in the various jurisdications. Deviation from the accepted norm causes irritation, delay, expense and criticism. Accordingly, it is important to encourage the trans-jurisdictional cooperation which is usefully being facilitated by the National Association of

Securities Administrators. The current Chairman of the Alberta Securities Commission has been the Chairman of this organization for the last two years; and the Committee thought it important to continue Alberta's leadership role here in the future. One tangible way to provide this leadership would be to provide financial support for the creation of a small but permanent Secretariat for this organization.

The vetting function assumes a more important role when the Alberta Commission has primary jurisdiction over local issues, small issuers, and matters within the particular expertise of the Alberta Commission (such as oil and gas). It might therefore be desirable for the Commission to allocate more of its resources to this slice of its vetting work.

The Committee rejected the view that the Commission should not perform any vetting function but should merely be a registry for the filing of documents because of (1) the impossibility of prescribing in advance all of the types of improper activity in the securities market (which forces one to conclude that the Commission must have discretion), and (2) the remedies in civil courts for failure to make "full, true and plain disclosure" (let alone other forms of improper activity) are simply inadequate, too expensive and too time consuming.

(c) Investigation, Enforcement and Prosecution

The Committee thought it important for the public and members of the securities industry to perceive that there is an active and effective surveillance function performed by the Commission: deterrence and prevention are infinitely better than either prosecution unchecked or unsavoury activity. The enforcement function shold be pro-active and not merely reactive to events. Accordingly, the Committee thought it desirable to continue to allocate significant resources to the enforcement function of the Commission for the foreseeable future. They also noted that the U.S. Congress over the last one or two years has significantly increased the budget of the Securities and Exchange Commission for surveillance, and the recent disclosures of unethical and illegal activity in the United States have led to a call from both industry and Congress to continue the more stringent enforcement function.

The complicated nature of transactions in the securities industry means that the quality of investigation into and prosecution of alleged offences requires considerable skill, and a combination of talents. Accordingly, there is considerable value in developing teams of investigators composed of financial analysts, accountants and lawyers. While ex-policemen definitely have a role in the investigation team, they do not necessarily

possess all of the skills required to make a successful investigation or to lead to an effective prosecution; other skills are now frequently required, too. Accordingly, the Committee thought that it would be a correct step for the Enforcement section to include a lawyer,[13] and for the staff to include chartered accountants with forensic experience. (It may be necessary to obtain these skills on an ad hoc contractual basis.) Because effective investigation does not rely solely on ex post facto auditing of a paper trail, it is also important for the Enforcement section to have personnel who are well versed in the securities industry, who are knowledgeable about the ways in which unscrupulous transactions can be consummated, and who have good communication with the street.

The Committee noted that ultimate responsibility for investigating possible violations of the Criminal Code lies with the police and that the Commercial Crimes Section of the Royal Canadian Mounted Police in Vancouver has developed considerable expertise in the securities area which has been useful with respect to crimes occurring in Alberta.

On the prosecutorial side, the Committee did not detect any

13 It is not necessary for the Deputy Director to be a lawyer; it is important that lawyers and accountants be actively involved from an early stage in the investigations.

difficulty in having the Crown Counsel from the Attorney General's Office conduct the prosecutions of Criminal Code offences relating to securities transactions.

Section 161 of the Act provides for a number of offences created by the Act to be tried in the Provincial Court. The investigation for these offences lies with the Enforcement section of the Commission itself, although it may receive assistance from the police from time to time. The effectiveness of this policing function by the Commission staff will be influenced by the comments above. On the prosecution side, however, section 162 provides that no proceedings shall be instituted under section 161 "... except with the consent or under the direction of the Attorney General". The Committee members recommended that this requirement be abolished by repealing section 162. On the one hand, they understood that some problems have arisen because of differences in the test for determining when the Attorney General's consent should be given and the higher test of whether a charge should be laid. In some cases, therefore, the consent of the Attorney General has been given, but the Crown prosecutor having carriage of the case has properly exercised his discretion to decline to carry on with the charges. On the other hand, there is no obvious reason why the Attorney General's permission should be required before any charge is brought under section 161. There is no indication that

the Commission has sought (or would recklessly seek) to lay charges under section 161, or that the requirement of obtaining the Attorney General's prior consent forms any useful brake upon any perceived improper zeal of the Commission. Therefore, the Committee recommended the repeal of section 162.

In passing, the Committee noted that there has been some diversity in the procedure used to prosecute offences under section 161. While the Attorney General's office has carriage of the prosecutions in Calgary, it appears that at least for some time legal counsel to the Commission had been designated as special counsel by the Attorney General to conduct similar prosecutions in Edmonton. While there is no indication that this diversity has caused any problem, it would be tidy to have a uniform procedure throughout the province.

While speaking about legal matters, the Committee noted that the Director of Enforcement is the only lawyer at the Commission who is employed by the Commission itself, and is not a member of the Attorney General's staff seconded to the Commission. It appears that the secondment arrangement has in fact generally worked well; and it is important that this arrangement continue to work. In particular, the Securities Act is a complicated and technical piece of legislation, which requires legal talent with expertise and some continuing experience with the Commission. It

is important, therefore, that there not be too rapid a turnover in the Commission's legal staff if it is to be effective.

The Committee also noted that the Commission itself does not have legal counsel independent from its staff. There may well develop circumstances in which the Commission needs legal counsel, but actual or perceived bias would prevent it from being advised by the lawyers on its staff or from the Attorney General's Department. To some extent, this potential conflict has been avoided by the happy coincidence that the Assistant to the Chairman has been a lawyer (although this position is not designated as a lawyer's position, and the incumbent is not recognized as a lawyer in the governmental hierarchy), who may therefore be available to give independent legal advice. In British Columbia, this problem has been solved by hiring a special counsel on contract to advise the Securities Commission itself and not its staff. It may be that a similar solution will need to be developed in Alberta, particularly if Model 3 is implemented.

It is also useful to review whether the offences under the current Act are appropriate today. The following table sets out a comparative analysis of the enforcement provisions regarding what the Committee has defined as Category 1 (excluding Criminal Code offences) and Category 2 matters.

Category 1 Offences - This category relates to offences punishable by summary conviction in Provincial Court pursuant to s. 161 of the Alberta Securities Act.

Province	Maximum Fine (Individual)	Maximum Fine (Corporation)	Maximum Prison Term
Alberta s. 161	$ 5,000.00	$ 75,000.00	1 year. (Note: the fine and prison term may be imposed as alternatives or in combination.)
B. C. s. 138	$100,000.00	$100,000.00	5 years less one day. (Note: the fine and prison term are alternative sentences and therefore can not be combined.)
Ontario s. 118	$ 25,000.00	$ 2,000.00	1 year. (Note: the fine and prison term can be combined.)

Category 2 Disciplinary Powers - This category involves the Commission's exercise of its discretionary powers on an ex post facto basis to discipline or impose sanctions on persons or transactions which the Commission finds unacceptable.

Province	Power to apply to Court for compliance order	Cease trade power	Removal of exemptions power
Alberta -(Note: All powers exercisable by the Commission only, although the Commission may delegate these powers to the Director under s. 14(3).)	s. 164	s. 165	s. 166
B.C. - (Note: All but the 1st power are exercisable either by the Commission or the Superintendent of Brokers.)	s. 140	s. 144	s. 145
Ontario - (Note: All powers exercisable by the Commission only.)	s. 122	s. 123	s. 124

Also, it has been suggested to the Committee that the Securities Commission should be given the power to impose additional sanctions such as the power to fine or to grant civil remedies in the course of exercising its discretionary disciplinary powers (Category 2 identified above -- currently, sections 168 through 171).

A related suggestion was made to the Committee that a more efficient civil remedy could be made available to investors if a way could be found to require binding arbitration of any dispute arising between a customer and an investment dealer or broker. Such a system exists successfully in the United States, and the by-laws of the Toronto Stock Exchange contain a provision which would permit arbitrations to occur although this provision has not in fact become operable. This arbitration system could easily be implemented if the two self-regulating organizations (the Alberta Stock Exchange and the Prairie Region of the Investment Dealers' Association) were to require all of the contracts between their members and their customers to contain an appropriate arbitration clause. The Committee recommended that such an arbitration system be implemented, and noted the existence of the Alberta Arbitration and Mediation Society, who would undoubtedly be of assistance in putting such a system in place and helping find and train arbitrators to make it operate.

It has been suggested to the Committee that an amendment could usefully be made to section 193 of the current Act which provides immunity to the Commission, its members, officers and agents for any act done in good faith under the Act. The reference to "good faith" has simply resulted in a number of actions instituted against individual officers of the Commission pleading "bad faith". The Committee agreed with the suggestion that this causes unnecessary embarrassment and concern for the individuals involved, and that it would be desirable to prevent a law suit against individuals in all circumstances. The Committee made this recommendation noting that sub-section 193(3) makes the Crown liable for torts committed by the Commission or its officers even if sub-section 193(1) did not make the reference to "good faith". Therefore, the recommendation to delete the reference to "good faith" in sub-section 193(1) would not deprive any plaintiff of his cause of action against the Crown, but would merely prevent the gratuitous harassment of naming individual employees as defendants.

Finally, the Minister asked the Committee to consider ways to shorten the time it takes to complete proceedings before the Commission, particularly where criminal proceedings are also involved, or where it is desirable to prevent an undesirable person from being involved in the exempt market. This problem involves the exercise of those functions of the Commission which

have been identified above as belonging to Category 2 -- namely, discretionary disciplinary powers to revoke or refuse registration of participants in the securities industry, or to refuse or revoke exemptions for particular transactions. Delay can arise if the Commission takes the view that it is not proper for it to embark on these regulatory proceedings so long as criminal matters (identified as Category 1) under the Criminal Code or section 161 of the Act are before the courts. This approach results in sequential proceedings, which necessarily elongate the total time for the completion of all proceedings, and sometimes permit undesirable participants or transactions to continue. It may be that there are a few cases in which such deference by the Commission is appropriate. However, the Committee submitted that this sequential approach is generally undesirable, should not be the general rule, and is not required by law. The whole purpose of delegating the Category 2 disciplinary powers to the Commission is to permit it to act quickly, less formally, and without having to meet the requirements for a conviction in a criminal court in order to prevent unacceptable activity in the securities industry. In the Committee's opinion, it is appropriate in most cases for the Commission to conduct its Category 2 proceedings prior to or simultaneously with the trial of Category 1 charges pending in the courts. (Of course, some co-ordination will be desirable between the Enforcement staff of the Commission with respect to

Category 2 matters and the police and Crown prosecutors with respect to Category 1 matters to prevent premature disclosure of a criminal investigation, but this should not unduly delay proceedings before the Commission.)

On a related point, section 21 of the Act permits the Commission or the Director (as the case may be) to make an interim order revoking registration or exemptions without conducting a hearing. Although such an interim order may only be made for only 15 days, it may be extended until the hearing into the matter is concluded. In other words, there is no reason under the current Act for a registrant to continue to be permitted to continue undesirable activities or to participate in the exempt market merely because of delays in the operation of the regulatory machinery requiring a hearing under the Act. Accordingly, the Committee concluded that no amendment is required to prevent these perceived abuses.

(d) Controlling the Exempt Market

It was suggested to the Committee that the exempt market may in fact be more important today than the market which is regulated under the Securities Act. Ontario has recently enacted policies which will require participants in the exempt market to

register, and to file documentation concerning exempt transactions, although no vetting function will be performed by the Ontario Securities Commission. In addition, Ontario has recently indicated that it will raise the historical $97,000 exemption, while British Columbia has taken precisely the opposite course of lowering the amount of that exemption. The Committee was not in a position to make recommedations on the appropriate approach to the exempt market, except to note that there is a wide category of exemptions contained in the Act (all of which can be revoked by the Commission) and the Commission has broad discretion to permit other exemptions from the peremptory requirements of the Act -- and there appears to be no comprehensive rationale underlying these exemptions. This is a matter which could usefully be sent to the Policy Advisory Committee for discussion.

(e) Location

It has been suggested to the Committee by some (but not unanimously) that the Commission should have an important presence in Calgary in light of that city's status as a financial centre. At the moment, while the Commission does have an office in Calgary, the staff located there belong to the Enforcement section. Although the Commission itself sits frequently in

Calgary, the Securities section involved in vetting prospectuses and other documents is located in Edmonton (as is the Franchises section). Accordingly, although an officer of the Securities section makes regular trips to Calgary, it is frequently the case that people from Calgary involved with this function of the Commission must either travel to Edmonton or communicate with the Commission by telephone. Although telephone communication does not appear to cause a problem when communicating from Calgary to the British Columbia, Ontario or Quebec Securities Commissions (or regulators in other jurisdictions), it does appear to be an irritant when dealing with the Commission in Edmonton. Accordingly, the Committee thought that it might be desirable to consider whether the Commission might transfer some of its Securities staff to Calgary so that all of the paperwork involved in vetting prospectuses and the like could take place physically in that city as well as in Edmonton.

In light of the great recent improvements made in the transmission of documents and communications generally, the Committee did not think that there is any serious problem in the actual transmission of documents from one city to another.

(f) Fees

Although the fee schedule under the Securities Act has recently been increased, the Committee recommended that serious consideration be given to attempting to make the Commission effectively self-financing. On the one hand, this would allocate costs to the private sector which properly belong on the private sector for maintaining a fair securities industry. On the other hand, it would provide the opportunity of identifying a pool of resources.

If this suggestion is pursued, some care should be used in designing the new fees. For example, it might not be desirable to levy the fees on the basis of a percentage of the value of a particular issue, because the total amount of work involved by the Commission does not vary directly proportionally with the value of the issue. Thus, it might be desirable to set a flat fee for each prospectus to recognize the cost of the general work involved in clearing any prospectus, perhaps coupled with a small percentage fee for issues over a certain size.

Accordingly, while the Committee was not in a position to recommend a specific fee schedule, it did recommend that consideration be given to making the Commission self-financing. (Note that Ontario is committed to achieving complete self-

financing, and that British Columbia has indicated its goal of achieving a significant level of self-financing.)

Therefore the Committee recommended that a study be undertaken regarding fees with the objective of making the Commission self-financing over a phase-in period of (say) three years.

VI. THE RELATIONSHIP OF THE COMMISSION TO THE ALBERTA STOCK EXCHANGE

This section of the Paper comments on the role of the Alberta Stock Exchange and its relationship to the Securities Commission. These comments are necessitated by section 52 of the Securities Act which prohibits the formation of a stock exchange in Alberta without the approval of the Commission, and gives the Commission a great deal of supervisory power over an approved exchange. Further, Part 17 of the Act recognizes the Commission's supervisory role over self-regulating organizations (which includes the Stock Exchange). Finally, the Exchange has the opportunity to play a significant part in maintaining a fair secondary market in securities. For these reasons, then, the Committee considered the following comments about the Exchange to be within its terms of reference.

The Alberta Stock Exchange ("ASE") is a continuation of the Calgary Stock Exchange, and is established by a Private Act of the Legislature (the "ASE Act").[14] The ASE Act provides that the ASE is a non-profit organization to be governed by a minimum of nine directors ("Governors") and a maximum of fifteen. Governors

14 Alberta Stock Exchange Act, 1974-75, c. 79.

are elected annually[15] by members of the ASE and constitute the Board of Governors (the "Board"). In addition, the ASE's by-laws require the election, by the Board, of two "Public Governors" (i.e. the election of two non-members) to the Board. Moreover, the Act provides that the ASE's object is to operate a stock exchange in Alberta for trading by ASE members and other persons authorized by the Exchange.

The ASE generates revenue by various means. Its two primary sources of revenue are trading fees and listing fees[16]. In addition, the ASE charges a monthly membership fee to all its members. This fee is used to cover the overhead expenses involved in the ASE's day-to-day operations. Moreover, a break even registration fee is charged for dealers and salespersons. Finally, the ASE receives funds for sale of seats on the Exchange floor, although these funds do not provide a steady income stream given that the sale of a seat involves a one-time payment.

15 In order to facilitate increased continuity on the Board of Governors, we suggest that the Board members serve a two or three year term with members' terms expiring on a staggered basis.

16 The ASE's annual operating budget is in the the order of $2,000,000 with approximately 50% of its revenue generated from new listings.

The ASE is one of two[17] self-regulating bodies recognized by the Securities Commission. Part 17 of the Securities Act makes recognition by the Commission a prerequisite to the existence of a self-regulating body. Moreover, Part 4 of the Securities Act provides that any person or company wishing to carry on business as a stock exchange in Alberta must be recognized in writing by the Securities Commission.

In addition to the aforementioned recognition requirements, the Securities Commission has broad regulatory powers over the ASE. First, section 52 of the Securities Act provides as follows:

> 52(1) No person or company shall carry on business as a stock exchange in Alberta unless it is recognized in writing by the Commission as a stock exchange.
>
> (2) The Commission may, if it appears to it to be in the public interest, make any decision
>
> (a) that it considers is necessary to ensure that issuers whose securities are listed and posted for trading on a stock exchange comply with this act and the regulations;
>
> (b) respecting the manner in which a stock exchange carries on business;
>
> (c) respecting any by-law, ruling, instruction or regulation of a

17 The other self-regulating body is the Prairie Region of the Investment Dealers' Association of Canada.

stock exchange;

(d) respecting the trading on or through the facilities of a stock exchange;

(e) respecting any security that is listed and posted for trading on a stock exchange.

(3) A person or company directly affected by any direction, order or decision made under a by-law, rule or regulation of a stock exchange may appeal the direction, order or decision to the Commission.

(4) Section 25 applies to an appeal made under subsection (3).

Secondly, section 179 of the Securities Act gives the Commission broad powers over all self-regulating bodies:

> The Commission may, if it appears to it to be in the public interest, make any decision with respect to
>
> (a) a by-law, rule or regulation or proposed by-law, rule or regulation of a self-regulating body,
>
> (b) a direction, decision, order or ruling made under a by-law, rule or regulation of a self-regulating body, or
>
> (c) any practice of a self-regulating body.

In light of these provisions of the Securities Act, it is clear that the Commission is provided with ultimate statutory control over the ASE. The degree to which such control is exercised in large measure will undoubtedly be a function of the degree of responsibility shouldered by the ASE in regulating its

own affairs including the level of resources that it is willing to allocate to regulatory matters: the more comprehensive the ASE's structure for self-regulation and the greater its capacity to deal with regulatory matters, the less likely the Securities Commission will feel the need to exercise its control.

The mechanism by which the ASE's self-regulatory role can be adjusted is set out in sub-section 183(1) of the Securities Act which provides:

> The Commission on the application of a self-regulating body may by order authorize the self-regulating body to administer this Act and the regulations or any provision of them as they relate to the members of the self-regulating body.

Currently, the ASE is only authorized to administer the Securities Act and the regulations relating to registration requirements,[18] leaving all other aspects of the Securities Act and regulations as they relate to ASE members to be administered by the Securities Commission. This leads one to question whether

18 A person or company wishing to trade securities in Alberta must be registered pursuant to the provisions of the Alberta Securities Act. All brokers must be a member of the ASE, with all registration requirements administered by by the ASE. Similarly, investment dealers must be a member of the IDA with all registration requirements administered through the IDA. A person or company not belonging to either the ASE or the IDA may apply to the Securities Commission directly for registration as a securities dealer; a security issuer; a mutual fund dealer; or a scholarship plan dealer; and will be subject to the direct supervision of the Securities Commission regarding all terms and conditions of registration imposed by the Commission.

or not a greater self-regulatory role should or could effectively be exercised by the ASE. There are various arguments for and against an increased self-regulatory role of the ASE, and these considerations will be addressed in turn.

The predominant argument in favour of increasing the ASE's role is that self-regulation is more efficient and effective than government regulation. This sentiment is echoed by Johnston[19] in his text on Canadian securities regulation where he states that,

> Consideration of moral standards and good business practice can often be more readily appreciated by persons who are actively engaged in a particular business than by an administrator who is less familiar with day-to-day practice and with the possible implications of various types of improper behaviour.

In further support of this proposition the English Parliament, in the recently passed Financial Services Act[20], has on a very large scale facilitated the increase of self-regulation in all aspects of the financial industry.

The most frequently raised argument against increasing the ASE's self-regulatory role is that a self-interested body makes a

19 Johnston, David L. Canadian Securities Regulation, Butterworth and Company (Canada) Ltd., 1977, p.387.

20 Financial Services Act 1986, c. 60.

poor regulator because its decisions are based upon the best interests of its members rather than the best interests of the public. Although this argument has merit, it is also true the long-run interest of the ASE requires it to maintain public confidence in the fairness of the Exchange's market. Accordingly, there is a relationship between the self-interest of the members of the Exchange and the broader public interest. To a large extent the Committee thought the possibility of self-interested self-regulation by the ASE to be merely a perception and not a serious real problem. However, perceptions are important, and the Committee recommended changes, discussed below, to the composition of the ASE's Board of Governors which might eliminate the adverse perception of self-interest in the ASE. Further, increasing the range of matters under the primary regulatory purview of the ASE, would allow the Securities Commission to concentrate its resources on effective supervision of the ASE, instead of requiring the Commission to devote its scarce resources to actually doing the largely clerical work of primary regulation itself. This higher level of supervision by the Commission would presumably be able to keep in check any self-interested decisions made by the ASE.

Another argument raised against increasing the ASE's self-regulatory role is that it will result in an overall increase in the regulation of the securities industry in Alberta. This

argument is based on the proposition that there will be dual primary regulation by the ASE and the Securities Commission of regulatory matters delegated to the ASE. This criticism is simply unfounded so long as the Securities Commission foregoes all primary regulation of delegated matters and focuses solely on the supervision of these matters. In other words, the allocation of greater primary regulatory responsibility to the ASE requires

(1) it to accept responsibility for this task, and

(2) the Commission not to duplicate these functions, but rather to supervise their effective achievement by the ASE.

The Committee submitted that the balance of the above arguments favours increased self-regulation, and therefore recommended that the ASE's self-regulatory role be increased in order to provide more efficient and effective service to its members, and ultimately to the investing public.

Another change the Committee recommended relates to the composition of the Board of the ASE. As previously mentioned, the by-laws of the ASE provide that two non-member "Public Governors" shall be selected by the Board. The Committee recommended that the number of Public Governors be increased to

five to be designated by someone other than the Board or members of the ASE. In particular, they recommended that the Public Governors should be appointed by the Lieutenant Governor in Council, because the Government represents the public interest and this would also recognize the fact that the Stock Exchange is a statutory monopoly. The Committee made this recommendation for a number of reasons. First, an increased number of Public Governors would help to dispel the "private club" image of the current Board. Secondly, a greater number of Public Governors would mean an increased number of decision-makers with an independence that may not always be found among the other Governors. Thirdly, a larger number of Public Governors may help ensure that the public is better informed of the business conducted within the Exchange. Finally, an increased number of Public Governors may provide some assurance by the Board to the public that their function is "...being performed in the interest of maintaining the Exchange as a public institution."[21]

In summary, the Committee recommended an increased self-regulatory role of the ASE and recommended an increase in the number of Public Governors elected to the Board. Both recommendations derive from the goal of promoting accountability and increased responsibility by the ASE to the investing public.

21 See note 19, supra, p.393.

VII. SHOULD FRANCHISES BE DEALT WITH DIFFERENTLY?

The regulation of franchises in Canada within the ambit of securities regulation is a relatively recent development. In fact, it was not until 1971 that Alberta passed the Franchises Act[22] , the only such legislation in Canada.[23]

The Franchises section of the Alberta Securities Commission is comprised of a Deputy Director and two analysts, and is charged with the administration of the Franchises Act.[24] The Franchises Act has a "public interest" mandate and essentially requires the registration of a prospectus regarding a franchise offering (or a statement of material facts) and the registration of franchise salespersons. A franchisee invests substantial time, money and effort into the franchise; and this provides the rationale for treating franchises as securities to be regulated in the public interest. In addition, there is frequently a significant inequality in the bargaining positions of a large and

22 Franchises Act, S.A. 1971, c. 38 as amended. The Act was derived from the equivalent California statute.

23 In the same year a Committee appointed by the Ontario Minister of Financial and Consumer Affairs recommended the implementation of legislation similar to the Alberta Franchises Act. However, to date, Ontario has not introduced Franchises legislation.

24 The Alberta Securities Commission is currently reviewing the Act with a view to recommending changes to make the Act more streamlined.

sophisticated franchisor and a small and unsophisticated franchisee.

The fact that Alberta is the only Canadian jurisdiction with specific franchises legislation does lead one to question whether such legislation is either necessary, desirable, or justifies the expense.

The most commonly stated benefit of Alberta's franchises legislation is that it assists in balancing the otherwise highly dominant bargaining position of the franchisor over prospective franchisees. In addition, the Franchises Act provides ex ante protection to franchisees. Such protection is advantageous to franchisees given the expense associated with ex post facto civil remedies.

On the negative side, there is a significant cost to franchisors for the legal services required to comply with the Act.[25] These costs and inconveniences associated with franchises legislation may be significant enough to cause potential franchisors to stay out of Alberta. Also, the franchise legislation imposes administrative costs on the public purse of the Province.

25 The Committee was advised that typical costs ranged between $10,000 - $20,000.

Could franchises be dealt with differently?

One way of dealing with some of the criticism of the current system, while retaining the perceived benefits, would be to streamline the Franchises Act to reduce the costs of compliance. However, it is not readily clear how such costs could be substantially reduced without eliminating most of the vetting of the prospectuses which are required to be filed. The current system operates on the assumption that the "full, true and plain disclosure" of all factors involved in the franchise agreement will somehow compensate for the frequent unequal bargaining power of the franchisee compared with the franchisor. On the one hand, it is not clear that this paperwork in fact achieves the goal of facilitating fairer bargains between unequal parties. On the other hand, it is also not clear that reducing the vetting of the paperwork would make it worthwhile retaining the present system at all.

Another method of dealing with franchises is to eliminate the Franchises Act altogether and implement some form of unfair contracts legislation similar to the Ontario Business Practices Act[26], which might permit ex post facto judicial review of and relief from unfair terms in franchise contracts. There might

26 Business Practices Act, R.S.O. 1980, c. 55.

also be a public education program about franchises.

In the final analysis, a decision as to whether to change the current franchise legislation is political, and the Committee did not make a recommendation on this point one way or the other.

VIII. WHAT WILL DEREGULATION BRING?

It is a fact that significant changes in the financial market place are currently taking place, and will continue. There have been many reports and studies in this area over the past several years, brought about by the following: the failure of two chartered banks and several trust companies; the question of foreign ownership of investment dealers; the continuing question of closely held financial institutions; and the breakdown of the so-called "four pillars".

The growing concentration of power and the dissipation of widely held ownership of many non-bank financial institutions will generate new challenges along with new risks. Any system of regulation and supervision must be in a position to respond to these challenges and risks and to remain flexible throughout this period of change. In addition, the regulatory system must be strong and alert not only to shift with the change but also to be prepared to take strong and positive regulatory action where required. There will be an increasing need for good sound regulatory judgement as many rules that are currently in effect may not be applicable or appropriate for the change that will be undergoing.

The use of computers and sophisticated transmission

facilities will have an increasing impact on the securities marketplace and all financial institutions. For example, we may see the abolition of share certificates in the near future. We may also see that written prospectuses will be discontinued in favour of an on-line computer prospectus that will always be up-to-date. In addition, there will be increasing change and growth in the use of national and international financial markets as the financial world becomes smaller.

There may be less business dependence on banks and more reliance on the marketplace with new financial instruments that have yet to be developed. There will be many new financial products and services offered in the coming years along with greater competition in the financial service marketplace. Regulation and supervision must be prepared to respond. Regulators must be keenly aware of such changes, and be as supportive and as forward-looking as possible. Nevertheless, regulators must be prepared to take strong and quick action where necessary to prevent abuses of fairness in such changing financial marketplaces.

One can also foresee, and support, that there will be greater use of self-regulating organizations ("SRO's") to which much of the regulation and supervision of the financial marketplace will be delegated by the regulatory authorities.

However, the regulatory authorities will retain the right to reassume these functions at any time.

It was not the Committee's place to comment on the changes that are being discussed or proposed arising from the breakdown of the "four pillars" and the conflict (perceived or real) between federal or provincial regulation. Many far-reaching decisions in this regard are currently being considered and will probably be decided within the next several months. Only time will tell if the decisions made and implemented will be the right ones. In any event, it will be most important for the provincial regulators to work closely together with each other in order to serve all Canadians in the best possible fashion, particularly as we become more international in our scope, as the financial instruments become more unique and innovative, and as the pressure of competition increases in the financial marketplace.

One thing is clear: There will be a continuing need for the Province of Alberta to regulate the securities industry.

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